



Philequity Corner (February 27, 2023)
By Wilson Sy

Cold war heats up

There are several factors that caused the stock market to drop and the US dollar to move higher. The recent market moves were driven by the prospect of higher for longer interest rates due to hotter-than-expected inflation. The cold war between the US and China is heating up (*Spy balloon*, February 20, 2023). Recent events suggest that the Russia-Ukraine war may escalate further. More importantly, Russia's saber-rattling and nuclear innuendos provide another dimension of risk to financial markets.

Higher for longer

Last Friday, the US reported that its personal consumption expenditures price (PCE) index rose 0.6% MoM and 5.4% YoY in January, the fastest pace since 1983. Coupled with the lowest unemployment rate since 1969, it appears that inflation remains persistently high despite the aggressive monetary tightening by the Federal Reserve (Fed) in the past year. This puts pressure on the Fed to keep interest rates higher for longer to bring down inflation, even though higher rates would hamper economic growth and increase the risk of recession. Due to expectations of more Fed rate hikes and a higher terminal rate, the US dollar index (DXY) is up 3.1% month-to-date. The USDPHP rate is now back at 54.87 as the peso fell 2.3% after reaching 53.65. From their recent highs, the S&P 500 is down 5.4% while the PSEi has fallen 6.3%.

Calling the bluff

Last week, US State Secretary Antony Blinken warned China against providing lethal support to the Russian war. He stated that some Chinese firms may already be providing non-lethal support to Russia. Despite these warnings, China's State Councilor Wang Yi visited Moscow. At the same time, a summit meeting between Vladimir Putin and Xi Jinping was announced to foster stronger cooperation between the two countries.

Buffett sells Taiwan Semiconductor

The recent decision of Warren Buffett to sell his stake in Taiwan Semiconductor may not only be due to the challenging global prospects for semiconductors, but also the intensifying US-China cold war. These coincide with recent provocations by China in disputed areas in Southeast Asia, and the bitter sovereignty conflict between China and Taiwan.

Finger on the trigger

As the cold war between US and China is heating up, the Russia-Ukraine war continues and may actually get worse based on recent developments. Last week, Russia withdrew from the New Start, a nuclear arms reduction treaty with the US. Russia's exit from the treaty would result in a lack of transparency and may spark an arms race between the US vs. China and Russia. Aside from the increasing nuclear threat, Russia hinted about attacking Moldova and floated the idea of pushing back Poland's borders. All these would worsen the hardships and tensions caused by the ongoing war in Ukraine.

UN condemns Russian invasion

Last Friday, February 24, was the one-year anniversary of the Russian invasion of Ukraine. On its anniversary, the United Nations (UN) passed a resolution that called for a stop to the war, the withdrawal of Russian forces in Ukraine, and the recognition of the latter's borders. The resolution was passed with an overwhelming 141 votes, with 32 abstentions and seven countries voting against it.

Birds of the same feather

Recent geopolitical events underscore the unique bond between China and Russia. In past articles, we highlighted that understanding the distinct personalities of Xi and Putin can help us comprehend the rationale for their actions (*Common Prosperity*, August 30, 2021). The two have similar characteristics which typify tough, seasoned autocratic leaders of communist/socialist countries. In our article about the start of the war, we said that people describe Putin as calculating, cunning, ruthless, determined, and strong-willed (*Russian invasion*, February 28, 2022). Keen observers note that these same traits also apply to Xi.

Cornered rat

In his interviews, Putin typically recounted his childhood experience with a cornered rat. In that story, Putin said that the rat jumped on him after it was cornered against the wall. Putin thereby stressed that one should never corner a rat. Putin likes to use this story as a veiled threat of war or nuclear action whenever he believes he is cornered by other countries such as the US. Now, the cornered rat has found an ally. Xi and Putin probably thought that they were being unduly antagonized by the US and other Western countries.

Balancing act for the Phils

Coinciding with its increased belligerence against the US, China is also flexing its might within the region. Recent Chinese provocations have resulted in territorial conflicts with Indonesia and the Philippines. We believe that our country has to play a delicate balancing act in light of the increasing geopolitical tensions between the US and China. A wise, esteemed friend whose views I deeply respect stated that it is important for the Philippines to stay neutral in the fight between global superpowers. He cited several historical examples where neutral countries were able to avoid catastrophic damage by not getting dragged into the wars of other countries.

Inflation, interest rates, and invasions

Recent events highlight that the cold war between the US and China may be heating up. This is aggravated by the ongoing war in Ukraine, the increasing nuclear risk posed by Russia, and its stronger ties with China. These coincide with China's recent provocations in Southeast Asia and the continuing China-Taiwan conflict. On the economic front, inflation continues to sizzle, thereby raising the prospect for further monetary tightening. These geopolitical and economic issues have fostered a risk-off environment which fueled the US dollar's strong rally and the drop of global equity markets. Markets will only recover if some of these concerns abate.

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